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Budget blowout forces Jokowi to curb subsidies

Windfall profits from commodities have not been enough to cover additional subsidy spending

Indonesian President **Joko Widodo** (Jokowi) faces growing protests following the reduction of fuel subsidies on September 3. His decision was caused by a threefold increase in the cost of fuel subsidies (against budget), and forecasts predicting that energy subsidies could reach 25 percent of the country's national budgeted expenditure this year. The 2022 state budget had initially set aside US$10 billion for energy subsidies, though Finance Minister Sri Mulyani Indrawati warned subsidies could reach US$47 billion without change. The withdrawal of fuel subsidies has led to a 30 percent rise in the prices of certain types of fuel. The price of popular Pertalite gasoline rose from approximately US$0.50 per litre, to US$0.67.

Thousands of protesters have rallied daily, calling for the government to reverse the first price hike on subsidised fuel in eight years. Cutting the subsidies – which have kept domestic retail fuel prices stable for several months – will contribute to inflation, which could exceed 6 percent this year.

Inflation and cost of living pressures have long been a major source of political tension in Indonesia. In 1998, rising prices sparked riots that helped topple long-term dictator President Suharto. Jokowi also faced mass protests when he raised fuel prices in 2014 after his election. With campaigning for the 2024 election starting next year, rising fuel and food prices will undoubtedly remain the top of the agenda.

Inflation Reduction Act strains Washington's relationship with South Korea

Seoul's discontent with the new Act evident in announcement of major investments

Washington's newly minted *Inflation Reduction Act* (IRA) is testing its relationship with key trade partners and allies, including **South Korea**. Last Thursday, **US** Commerce Secretary Gina Raimondo and her South Korean counterpart exchanged "frank views" relating to the new EV tax credit requirements. As things currently stand, none of the EVs made by Kia and Hyundai will be eligible for the IRA's US$7,500 EV tax credit.

The tax credits will become increasingly severe over time and qualifying requirements will go well beyond the initial need for vehicles to be assembled in North America. Starting next year, 40 percent of an EV's battery minerals, and 50 percent of the battery components must come from the US or an FTA partner to be eligible for the full credit. By 2027, these requirements will rise to 80 percent for minerals, and 100 percent for battery components. EV manufacturers could suffer further significant disruption from 2025, when vehicles with any minerals or components from "foreign entities of concern" become ineligible. This is concerning for South Korea given that more than 80 percent of its imported lithium, graphite, and cobalt is from **China**, alongside 85 percent of its anodes, and 73 percent of its cathodes.

Tax credits under Washington's previous scheme were mainly restricted to when a manufacturer sold at least 200,0000 qualifying vehicles for use in the US, with the mineral content and component percentages of vehicles not considered. South Korean officials have signalled that the tougher eligibility requirements may spur companies to rethink over US$13 billion in recently pledged US investments. With both the US and China advancing their own industrial policies, Seoul is at risk of being squeezed. It remains to be seen whether the US will be willing to moderate the more restrictive elements of the IRA.

China's chip companies face widening export controls and labour market woes

Over 3,000 Chinese companies have closed this year

Achieving self-sufficiency in the semiconductor industry has been of paramount concern to **China**. Beijing's flagship public private investment vehicle – the China National Integrated Circuit Industry Investment Fund – has invested over US$50 billion in the sector to date. A further US$25 billion has been invested through 15 local government funds. Despite considerable state largesse, the industry is facing severe headwinds. So far this year, nearly 3,500 semiconductor-related companies have closed their doors – up from around 1,400 in 2020. Though China appears to be manufacturing lower grade chips domestically, it remains dependent on the **US** for semiconductor goods with imports rising from US$4 billion in 2015 to US$10 billion in 2021.

Labour shortages, currently estimated at over 250,000 workers, are another pressing concern. Previous attempts to fill labour gaps involved 'crash courses' – classes intended to upskill workers who lacked sufficient experience in the semiconductor industry. This only caused an influx of under-skilled workers. Another compounding challenge is increasingly stringent US export controls. Restrictions imposed throughout July and August limit China's access to the most advanced AI chips, electronic design automation software and graphic processing units. Without domestic alternatives, China's chip industry lagging behind its competitors.

Germany struggles to secure gas supplies before winter

Scholz scours the Middle East to secure gas contracts

Last week, **German** Chancellor **Olaf Scholz** met with **Qatari** Prince **Tamim bin Hamad Al Thani** as part of a broader Gulf visit aimed at securing alternatives to **Russian** energy imports. Scholz also met with **UAE** President **Mohammed bin Zayed** and **Saudi Arabia**'s Crown Prince, and newly-appointed Prime Minister, **Mohammed bin Salman**. Scholz came away bearing at least some fruit. The UAE promised to deliver 137,000 cubic metres of LNG to an under-construction terminal in north-west Germany. This is a modest contribution, with Germany consuming 90.5 billion cubic metres of natural gas in 2021. The UAE also agreed to supply low-carbon ammonia to German companies Steag and Aurubis to help support the decarbonisation of industrial sectors. In May, Berlin leased four floating storage and regasification units capable of importing at least 5 billion cubic metres of seaborne gas per year.

While Germany has successfully filled around 91 percent of its gas reserves, this is not expected to last through the winter. Elaborate LNG export networks across the Gulf, including long-term contracts with countries such as **China** and **Japan**, leave limited capacity for an expeditious ramp-up of supply to Germany. In Saudi Arabia's case, there is a lack of requisite infrastructure to export LNG despite their over 850 trillion cubic metres of reserves. Overall, the sum of agreements reached during Scholz's Gulf sojourn are far from sufficient.

Utilities face mounting collateral requirements amid volatile energy markets

Governments are stepping in to stave off a wave of cascading defaults

A worsening liquidity crisis in **EU** energy markets has raised the risk of widespread defaults. Surging energy prices have driven up margin call requirements to untenable levels. Margin calls are required by exchanges as collateral to guarantee trading positions in the futures market. They are typically paid in cash. This week, EU utilities face margin calls of over €1.5 trillion – equivalent to more than 5 percent of the EU's GDP – to secure their positions. In some cases, requirements have risen by €1 billion to €5 billion in just a week. Governments are stepping in. Earlier this month, **Finland** and **Sweden** established liquidity facilities totalling US$33 billion. **Germany** is set to establish a US$67.9 billion loan guarantee mechanism to be overseen by state development bank KfW in the coming weeks.

The European Commission last week proposed options for reform amid pressure to alleviate the strain on energy producers. Measures proposed include broadening what is accepted as collateral, capping the price of electricity, and offering bridging loans or even directly providing collateral. The EU's securities market regulator, ESMA, is considering allowing EU sovereign bonds, bank guarantees or emissions allowances to be used as collateral. The Intercontinental Exchange plans to accept EU emissions allowances. With regulatory approval, emissions allowances could be accepted within the next two weeks. However, some diplomats in Brussels have also cast doubt on the bloc's ability to intervene. They are cautious of transferring risk from the energy sector to the financial sector if lower-quality collateral or no collateral is accepted. In the meantime, governments are likely to remain the emergency backstops for utilities.